

ICPS newsletter

Experts forecast further growth of the Ukrainian economy

A high level of business activity and a favourable external economic situation will assure the growth of the Ukrainian economy, despite the small grain harvest and the consequent downturn in agricultural production. This year, Ukraine's GDP growth is expected at 5.7%, and next year at 5.5%. That is the opinion upheld by participants of the "Consensus Forecast" project, under the framework of which leading researchers work together on a forecast of Ukraine's economic performance

On 26 September, the regular quarterly seminar on macroeconomic forecasting took place, bringing together representatives of government and non-government research institutions¹ at the Ministry of Economy and European Integration to unveil and discuss their forecasts for Ukraine's economic development.

Economy bolstered by investment activity and exports

The eight-month results for 2003 show Ukraine's economy demonstrating a higher economic growth rate than the forecasters had expected. The downturn in agriculture was offset by gains in construction and industry. The experts also noticed very high investment activity, which analysts believed to be sparked by either the desire of investors to place their money prior to the risky period of the presidential election or by their positive expectations regarding certain tax cuts starting in 2004. Another positive factor in the growth of the Ukrainian economy came from high export revenues. As to which of the two factors will become the major driver behind the economic growth next year, here the experts' opinions split.

GDP is climbing under moderate inflation

Compared to the previous seminar, held in May, the following basic changes took place in the consensus forecast:

- The forecasted indicator of GDP growth increased; by YE'03 it will measure

5.7%, and 5.5% in 2004, which is higher by 0.7 and 0.2 percentage points (p.p.), respectively, than had been previously forecasted;

- Expectations regarding foreign trade improved; the forecast for exports and imports were increased, respectively, by 3.2 and 2.6 p.p. for 2003 and by 3.3 and 2.8 p.p. for 2004. Experts predict that the share of foreign trade in Ukraine's GDP will diminish; based on the data of the latest forecast, export and import indicators in 2003 will stand, respectively, at 56.8% and 53.1% of GDP, against 54.3% and 51.6% of GDP in 2004;
- Analysts are confident about the stability of the UAH/USD exchange rate, which is expected to stay at 5.34 UAH/USD by end of 2003; and by end of 2004, the exchange rate will only move to 5.40 UAH/USD. This confidence is inspired by the NBU's expanding international reserves, the forecasted value of which is to increase by an average 1,370 and 1,990 million USD for the next two years, totalling 6,679 million USD in 2003 and 8,040 million USD in 2004;
- The expected average weighted commercial bank lending interest rate was cut to 17.8% in 2003; however, it was revised and adjusted upwards for 2004, to 16.4%; the trend continues for cheaper bank loans, but at a slower rate than had been expected previously, in view of high inflationary expectations

among the Ukrainian population. The experts also emphasised improvements in the composition of bank loans, namely, increased shares of long-term loans and deposits;

- The forecast for a rise in consumer prices (inflation) for 2003 was left unaltered; as with the previous forecast data, it will stand at 7.6% by 2003 year-end. The forecast value was raised by 0.7 p.p., to 5.7% for 2004 year-end;
- The monetary supply indicator was increased significantly for the 2003 year-end, accruing an additional 15.2 p.p. compared to the previous seminar and reaching 45.2%.

Optimism prevails in experts' assumptions

The consensus forecast is constructed by deriving an average value for the major macroeconomic indicators forecasted by all seminar attendees. The analysts base their forecasts upon certain assumptions that they believe will make the predictions come true. The assumptions below were most frequently mentioned as factors shaping the forecast.

Real sector

Household incomes will rise, thanks to the raise in minimum wages to 237 UAH per month starting 1 December 2003, as well as a cut in the personal income tax rate to 13%, taking effect on 1 January 2004, and increased public outlays from the budget prior to the presidential election. Some experts held that improved household incomes will push up imports, thanks to the increased consumer demand for higher-quality products.

The upcoming presidential election was also enumerated among the chief factors spurring privatisation in 2003 and in early

¹ This time, the following organisations took part in the seminar: The Support Group for the Coordination Council on Financial Sector Policy, Institute for Economic Research and Policy Advice, Institute for Economic Forecasting of the National Academy of Sciences of Ukraine, GfK-USM company, Alpha&Co company, International Centre for Policy Studies (ICPS), Ministry of Economy and European Integration of Ukraine, National Bank of Ukraine, IMF Resident Representative Office in Ukraine, and the WB Country Office in Ukraine.

2004, as well as the source of dampened investment activities on the eve of the election.

External sector

Most experts are counting on the accelerated growth displayed by the economies of Ukraine's major trading partners, and the acknowledgement of Ukraine by the European Union and the USA as a market economy. Certain experts anticipated a faster rise in imports compared to exports and, hence, a worsened

current account balance. Opposing opinions were voiced regarding the forecast demand for Ukrainian exports; unlike the optimistic scenario for unfolding developments, some analysts were of the opinion that demand for Ukrainian products abroad (in particular, metal and chemicals) will gradually diminish as competition intensifies and global markets saturate.

Monetary policy

The experts forecasted that monetary expansion will largely happen via the

forex market, and again put forth their assumption that the National Bank will stick to its policy of maintaining a steady nominal hryvnia exchange rate.

Nonetheless, as far as the decline in commercial bank lending interest is concerned, opinions have diverged—certain experts expect this trend to slow down, given the higher inflationary expectations in Ukraine this year.

Fiscal policy

The experts deemed the chief factors influencing the budget sector were the cuts in tax rates and the cancellation of tax benefits across sectors to take effect starting 1 January 2004. Most analysts believed that such a measure would cause budget losses in the short run. When forecasting the budget balance for 2003, the experts ventured figures within the range of -1.1% to 0.3% of GDP, having failed to agree on whether the budget should show a deficit or a surplus; yet, as regards the 2004 budget, all experts forecasted a deficit (on average -0.8% of GDP, with the marked forecasted value for the deficit reaching -1.5%).

Risks

Observers maintain that the seminar demonstrated that forecast-makers in Ukraine are paying increasingly more heed to forecast risks; most organisations voiced their warning about the probability of their forecast proving true and the impact upon it of certain factors, of which the most frequently mentioned ones were:

- blockage of the tax reform or amendments to tax legislation in order to avoid dramatically deteriorating the environment for doing business;
- partial loss of markets for Ukrainian exports, and worsened prices in global markets;
- intensified administrative interference in the economy;
- extremely tense political situation, caused by the fall 2004 presidential election, the constitutional reform, and the CEA agreement. ■

The International Centre for Policy Studies has been producing quarterly forecasts of Ukraine's economic development since 1997. For further information regarding ICPS forecasts, please contact Andrew Blinov (ablinov@icps.kiev.ua), tel.: +380-44-236-1292.

Table of average macroeconomic forecast for 2003–2004

Index	Consensus forecast		Index	Consensus forecast	
	2003	2004		2003	2004
Real sector	(mill UAH)		Capital account	-3.6	-2.7
Nominal GDP	247,555	277,584	FDI	2.0	1.7
Consumption	188,426	212,201	Exchange rate	(UAH/USD)	
private	136,842	156,567	Average annual	5.33	5.37
public	51,584	55,634	Year-end	5.34	5.40
Investment	49,810	57,210	Public finances	(mill UAH)	
Gross accumulation			Total revenues	71,131	74,980
of fixed capital	51,667	58,663	Total expenditures	72,649	77,186
private	44,842	49,649	Overall balance	-1,518	-2,206
public	6,263	6,868	<i>Financing items</i>		
Net exports of goods			Privatisation	2,042	2,170
and non-agency services	9,315	8,070	Domestic borrowing	-877	705
Gross national savings	64,868	70,479	Foreign borrowing	597	165
Real sector	(index, year-over-year)		Public finances	(% of GDP)	
Real GDP	105.7	105.5	Total revenues	28.7	27.0
Consumption	106.1	106.0	Total expenditures	29.3	27.8
private	105.8	107.7	Overall balance	-0.6	-0.8
public	106.2	101.3	<i>Financing items</i>		
Investments	111.7	109.1	Privatisation	0.8	0.8
Gross national savings	106.3	105.6	Domestic borrowing	-0.4	0.3
Inflation	(index)		Foreign borrowing	0.2	0.1
GDP Deflator			Money and credit	(mill UAH)	
(average annual)	105.9	106.6	Monetary base,		
CPI (average annual)	105.2	106.5	year-end	42,855	55,280
Dec. to previous Dec.	107.6	105.9	Dec. to previous Dec., %	39.1	29.0
PPI (average annual)	106.9	105.8	Money supply (M3),		
Dec. to previous Dec.	107.0	105.3	year-end	94,160	126,318
External Sector	(mill USD)		Dec. to previous Dec., %	45.2	34.2
External Sector	2,945	2,474	Average weighted		
Export volumes	26,355	28,086	interest rate on		
Import volumes	24,657	26,692	commercial bank hryvnia		
Revenues balance	-641	-657	loans, %, average annual	17.8	16.4
Official transfers (net)	1,887	1,737	NBU international		
Capital account	-1,682	-1,375	reserves, mill. USD	6,679	8,040
FDI	923	895	Social indicators		
External Sector	(% of GDP)		Population, mln. of people	47.76	47.43
External Sector	6.3	4.8	% change over previous		
Export volumes	56.8	54.3	year,	98.9	99.3
Import volumes	53.1	51.6	Average wage, UAH	453.3	522.1
Revenues balance	1.4	-1.3	% change over previous		
Official transfers (net)	4.1	3.4	year,	108.4	111.4